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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-15

CONTINENTAL T.V., INC., A&G SALES, SYLPAC AND S.A.M. INDUSTRIES, INC., *Petitioners,*

v.

GTE SYLVANIA, INCORPORATED, *Respondent.*

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE ON BEHALF OF THE ASSOCIATED EQUIPMENT DISTRIBUTORS

AND

BRIEF AMICUS CURIAE ON BEHALF OF THE ASSOCIATED EQUIPMENT DISTRIBUTORS

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The Associated Equipment Distributors ("A.E.D.") respectfully moves for leave to file a brief *amicus curiae* in support of Respondent.* In support of this motion the Associated Equipment Distributors states as follows:

1. The Associated Equipment Distributors is a national trade association composed of approximately 900 independent companies which distribute construction and related equipment throughout the United States.

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* Pursuant to Rule 42 of the Rules of this Court, the Associated Equipment Distributors requested consents from all parties to the filing of a brief *amicus curiae*. Counsel for Petitioner declined to grant such consent; Counsel for Respondent stated that in view of Petitioner's refusal to give consent, he would take no position concerning AED's filing of a brief *amicus curiae*.

A.E.D. members also service and repair new and used construction equipment at their facilities or at construction sites where the equipment is used. Most A.E.D. member companies hold franchises from manufacturers of construction equipment to distribute one or more lines of construction equipment. As a matter of practice, a substantial number of construction equipment franchisees are the exclusive distributors of the manufacturer's products within a defined territory or trade area. Some franchise agreements specify the distributor's location as the place where the franchise is granted. These agreements, while not placing geographic restrictions on sales, do require notification to and approval by the manufacturer before the location may be changed or before any equipment may be sold at other sites.

2. As explained above, the trade practices generally utilized in the construction equipment distribution industry entail exclusive distributorships and location restrictions and are, in these respects, strikingly similar to those under consideration in this instant case. The Court's decision in this case—whether a distribution system incorporating location restrictions is *per se* illegal—is therefore of utmost concern to A.E.D. as it will largely determine the legality of the industry's method of operations.

3. A.E.D. believes that it is essential to present to the Court the views of the small, independent distributors represented by the Associated Equipment Distributors. The Respondent, whose position A.E.D. supports, is a manufacturer and therefore unlikely to be able to adequately present to the Court the arguments and concerns that should be made on behalf of distributors.

For the foregoing reasons, the Associated Equipment Distributors respectfully requests leave to present its views by filing a brief *amicus curiae* in support of Respondent.

Respectfully submitted,

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BRIEF AMICUS CURIAE ON BEHALF OF THE ASSOCIATED EQUIPMENT DISTRIBUTORS

This brief *amicus curiae* on behalf of the Associated Equipment Distributors is submitted contingent upon the Court granting the accompanying Motion of the Associated Equipment Distributors for leave to file a brief *amicus curiae.*

INTEREST OF THE AMICUS CURIAE

The interest of the Associated Equipment Distributors is set forth in its annexed motion for leave to file a brief *amicus curiae.*

SUMMARY OF ARGUMENT

The adoption of a *per se* rule of illegality to location restrictions will have a lethal effect on the franchise and independent dealer distributorship operations commonly found in the construction equipment distribution industry. A *per se* rule will preclude distributors from obtaining exclusive franchises and as a result distributors will be unwilling or unable, because of the financial commitment required, to effectively distribute complex and expensive construction equipment. This will have the anti-competitive effect of reducing the number of distributors, encouraging the growth of a few large distributors, compelling manufacturers to integrate the distribution process into their operations and forcing other manufacturers out of business unless an alternative distribution system can be found. Unless this court is prepared to inter the exclusive franchise concept it must affirm the court's decision below.

This case is not controlled by this Court's decision in *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); nor should *Schwinn* be extended to the trade practices at issue here. Moreover, the *per se* aspects of *Schwinn* are in the nature of *dicta* since that issue was admittedly not before the Court and was neither briefed nor argued. In any event, the Court should recede from any implication that the *per se* rule of *Schwinn* applies to location restrictions since the alienation of property principle relied on in *Schwinn* has no relation to anti-trust considerations. Additionally, extension of a *per se* rule here would ignore both policy considerations established by Congress in the Lanham Act and the effect this decision will have on

the position of manufacturer and distributor under other laws.

The location restrictions at issue here have neither a pernicious anti-competitive effect nor lack any redeeming virtue. Therefore they do not meet this Court's test for *per se* illegality and must be judged under the rule of reason. The application of the rule of reason test will not render the lawfulness of such restrictions unpredictable; nor will it impose untoward obligations on the judiciary simply because it requires the courts to undertake an analysis of the restrictions in each case.

ARGUMENT

I. Reversal of the Lower Court Decision Will Have Substantial Anti-Competitive Effects and Will Frustrate the Purposes of the Sherman Act.

It is well recognized that a manufacturer of a product has the right to select its customers and may "franchise" specified dealers to whom it sells its goods. *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365, 376 (1967). The lawfulness of such a distribution system is unaffected if the manufacturer decides to confine its sales exclusively to one franchised dealer in a territory even if this causes the elimination of other distributors. *Joseph E. Seagram & Sons, Inc.* v. *Hawaiian Oke & Liquors, Ltd.*, 416 F.2d 91 (CA9, 1969), cert. denied, 396 U.S. 1062 (1970). The accommodation of such franchising policies to the antitrust laws stems from recognition of the fact that the franchising method of operation affords independent businesses perhaps the only viable means to become efficient and effective competitors of large, vertically integrated giants. *United States* v. *Arnold, Schwinn, supra* 388 U.S. at 386-387 (Stewart, dissenting). A.E.D. submits that the adoption of a rule of *per se* illegality in this case, ignores these accepted principles. Instead, a *per*

se rule will significantly encourage the vertical integration of independent distribution systems and will signal the end of the franchise and independent dealership concept.

These adverse consequences may be illustrated by reference to the construction equipment distribution industry. Manufacturers of construction equipment frequently distribute their products by granting exclusive franchises to dealers at specified locations. In reliance on the exclusive franchise the distributor, who essentially is a small businessman, will borrow and expend substantial sums to build showroom and repair facilities, train service personnel, purchase necessary service equipment and engage in various promotional efforts.[1] Absent the assurance that it will be the manufacturer's exclusive representative, it is unlikely that the distributors would undertake—or be able to obtain financing for—these expenditures.

It is not difficult to see how the imposition of a rule of *per se* illegality to a location clause restriction would sound the death knell for such methods of distribution. Initially, as the court below cogently observed, "under the rule of *per se* illegality, *if a dealer is franchised anywhere he is franchised everywhere.*" 537 F.2d at 998 (emphasis in original). This means that since a manufacturer would be required to sell to a franchised distributor irrespective of its locations, the manufacturer would be unable to guarantee to any dealer the right of an exclusive franchise. Lacking the assurance of an exclusive distributorship, few distributors would agree to expend the enormous resources attendant to purchasing, selling, and servicing complex and expensive construction equipment.

[1] Some of the larger construction equipment distributors have upwards of 7 million dollars invested in plant, equipment, inventory and parts.

The inability to attract a sufficient number of dealers might well confront manufacturers of construction equipment with a serious dilemma concerning the marketing of their products. The most obvious solution to the shortage of dealers would be that manufacturers would vertically integrate the distribution process into their operations with the consequent elimination of those independent distributors remaining in business. However, many manufacturers are financially unable to absorb distribution processes, or for other reasons the distribution processes are unsuited to their operations. These manufacturers face elimination from the market unless they can devise alternative distribution methods. The adoption of a *per se* rule that would produce such consequences—i.e., contributing to the demise of independent distributors and aiding the disappearance of manufacturers—is obviously at odds with the pro-competitive policies imbedded in the Sherman Act and therefore should be rejected.

Moreover, the anti-competitive effects suffered by distributors if the lower court is reversed will not be confined to the aforementioned difficulties in the vertical aspects of the distribution process. There will also be deleterious effects to existing franchised distributors of a horizontal nature. For example, any large, well-financed distributor holding or obtaining a franchise in an undesirable location could immediately enter other more lucrative markets. Such distributors would skim the cream off such markets without incurring advertising, sales or service costs that the exclusive distributor in that location has expended to develop good will and product acceptability for that market. In the final analysis, the larger and more financially sound distributors would, by economics of scale, drive out smaller

distributors until only a few giant nationwide distributors remained. This, in turn, would yield increased centralization, decreased competition, and a net anti-competitive effect—results in fundamental disharmony with the Sherman Act's design of promoting competition.

II. The Court's Decision in United States v. Arnold, Schwinn Should Not Be Extended To Location Restrictions.

The court below refused to extend this Court's decision in *United States* v. *Arnold, Schwinn supra* to Sylvania's location restrictions finding that the factual contexts presented in the two cases were neither "analogous or similar, even remotely." That decision is clearly correct. *Schwinn* involved vertically imposed territorial and customer restrictions that absolutely foreclosed intrabrand competition. Sylvania's "elbow room" practices on the other hand, while limiting a dealer's location, placed no restriction on extraterritorial sales or customers. Combined with Sylvania's practice of franchising competing dealers within any given territory the "elbow room" policy preserved a degree of intrabrand competition far exceeding that found in lawful exclusive dealerships.

Apart from these factual dissimilarities, several additional considerations militate against according *Schwinn* a broad sweep. Initially, *Schwinn's* rule of *per se* illegality must be subjected to special scrutiny since that issue was neither presented nor briefed to the Court.[2] Indeed, Justice Fortas' opinion in *Schwinn* refers at several points to the absence of the *per se* issue before the Court:

[2] See Pollock, *The Schwinn Per Se Rule: The Case for Reconsideration,* 44 Antitrust L.J. 557, 565-566 (1975).

> In this Court, the United States has abandoned its contention that the distribution limitations are illegal *per se*. Instead we are asked to consider these limitations in light of the "rule of reason. . ." 388 U.S. at 1860.

and

> The Government does not contend that *a per se* violation of the Sherman Act is presented by the practices which are involved in this appeal . . . . Accordingly, we are remitted to an appraisal of the market impact of these practices. 388 U.S. at 373.

Not having the *per se* issue before it, the Court's consideration of that issue took place without benefit of the views of all interested parties and must be viewed in the nature of dicta. In such circumstances, serious reservations exist concerning the wisdom of extending the *Schwinn* holding to the trade practices under consideration in this case or in otherwise giving *Schwinn* broad latitude. Indeed, A.E.D. submits that the fact that the *per se* issue was not before the Court in *Schwinn* renders suspect that aspect of the *Schwinn* decision itself.

In any event, assuming *arguendo* that *Schwinn* is sufficiently broad to encompass the location restrictions involved here such breadth should be curbed. The only rationale given by the *Schwinn* court for imposing a *per se* rule to sale transactions was that it would violate "the ancient rule against restraints on alienation . . . ." 388 U.S. at 380. However, there is no inherent relationship, nor does *Schwinn* furnish one, between restraints on alienation and the suppression of competition.

Instead, borrowing freely from the rule against restraints on alienation of property the *Schwinn* court considered it to violate the Act, *per se,* simply if a manufacturer reserved any control once it parted with dominion over the product. Whatever the merits of the alienation of property principle in ancient times, it should not be mechanically incorporated into antitrust legislation and applied to the present day economic structure. Unlike earlier historical periods, today's manufacturers and distributors are vitally concerned with their product after it passes from their control. Manufacturers and distributors expend vast sums on national and local advertising, quality control, repair and servicing facilities. These expenditures are incurred to insure the product's integrity and its continued salability in a national market place. These factors are of great concern to manufacturers and distributors irrespective of whether they retain dominion over the product. Moreover, distributors and manufacturers are becoming increasingly responsible under Products Liability law and Occupational Safety and Health legislation [3] for product defects after title has passed. Accordingly, they must be concerned with the products' destiny once it leaves their hands and necessarily must impose some restrictions during that period. These factors persuasively demonstrate that it would be improper to permit the passing of title to be the litmus test governing whether restrictions on resale are *per se* violative of the Sherman Act.[4]

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[3] Cf. *Frohlick Crane Service, Inc.* v. *OSHRC,* 521 F.2d 628 (CA 10, 1975).

[4] A reversal of the lower court's decision here might also have substantial and adverse impact on the law of trademarks. Federal law provides that a certification mark owner must insure that the product or services identified by the mark meets all owner quality standards or risk cancellation or abandonment of certification rights (15 USC Sec. 1055, 1064(e)(1) (1964). Quality control through the required establishment of extensive and adequate service facilities seems essential to carrying on the obligations of this national policy. While the Lanham Act specifically provides that an antitrust violation is not condoned by the trademark law (15 USC Sec. 115(b)(7)), a mechanical application of the *Schwinn* per se concept here would prevent the dovetailing of the quality control concepts of Lanham and antitrust policy. Indeed, that portion of the trademark law would be rendered inoperative.

Relying on such reasoning, several lower courts have refused to extend the *Schwinn* rationale to cover reasonable product restrictions imposed by the manufacturer after it relinquished dominion to the product. See e.g., *Tripoli & Co.* v. *Wella Corp.,* 425 F.2d 932 (CA 3, 1970), cert. denied, 400 U.S. 831 (1970) (restriction on resale of beauty products intended for professional use because of safety considerations); *Adolph Coors Company* v. *F.T.C.,* 497 F.2d 1178, 1187 (CA 10, 1974) cert. denied 419 U.S. 1105 (1975) (sales to distributors may be conditional on maintenance of conditions necessary to control the quality of the product); *Salco Corp.* v. *General Motors Corp.,* 517 F.2d 567 (CA 10, 1975) (restriction on automobile dealer location). The same reasoning should be applied to location restrictions similar to those at issue here, inasmuch as they have pro-competitive effects and are motivated by legitimate considerations. We respectfully urge the Court therefore to make clear that no implication may be drawn from *Schwinn* that all product restrictions applicable after title passes—and specifically location restrictions—are *per se* unlawful.

III. Since Sylvania's Location Restrictions Are Neither Perniciously Anti-Competitive Nor Without Redeeming Value They Do Not Meet This Court's Test For Per Se Illegality And Therefore Must Be Judged By The Rule Of Reason.

Since *Standard Oil Co.* v. *United States,* 221 U.S. 1 (1911) it has been settled that Section 1 of the Sherman Act prohibits only unreasonable restraints in trade. Accordingly, this Court has adopted a "rule of reason" test that is ordinarily employed to measure whether challenged business practices violate the Act. *Standard Oil Company* v. *United States,* supra; *Chicago Board of Trade* v. *United States,* 246 U.S. 231 (1918); *United States* v. *Topco Associates, Inc.,* 405 U.S. 596 (1972). This Court has also recognized another, limited, category of business relationships that violate the Act *per se* without the need for an inquiry into their reasonableness. In order to fall within this *per se* category the challenged activity must consist of conduct which meets the following test:

> "... agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."

Northern Pacific R. Co. v. *United States,* 356 U.S. 1, 5 (1958).

Unlike price fixing, tying arrangements, group boycotts or horizontal divisions of markets, Sylvania's "elbow room" distribution system did not meet either half of the two-part test for "*per se*" illegality. It produced neither a "pernicious effect" on competition nor did it lack any "redeeming virtue". To the contrary, as both the record and the Court's decision below make plain, the "elbow room" policy achieved substantial pro-competitive effects and was motivated, not by a desire to "stifle competition",[5] but to enable Sylvania to become an effective interbrand competitor. Lacking the elements that are prerequisite to inclusion in the *per se* category, this Court's decisions require that Sylvania's distribution practices be examined under the rule of reason test. See cases cited *supra* p. 10.

To decline to apply the *per se* label to the location restriction aspect of Sylvania's "elbow room" policy neither immunizes all such arrangements from antitrust liability nor opens a Pandora's box of uncertainties concerning antitrust enforcement. First, notwithstanding the inapplicability of the *per se* rule to location restrictions, the rule of reason stands as sentinel to curb such practices whenever they produce unreasonable anti-competitive effects. As the Court below observed:

> Our choice of a rule of reason test over a *per se* rule of illegality means only that the critical policy question will at least be asked and answered. In our view the Sherman Act demands no less [footnote omitted].

Nor may any perceived difficulties attendant to a rule of reason test justify resort to a *per se* approach. First, the economic analysis required to weigh competitive advantages and disadvantages flowing from vertically imposed location restrictions do not exceed judicial capabilities. Indeed, in at least two cases involving vertical restraints this Court has directed that the analysis be made. See *White Motor Co.* v. *United States,* 372 U.S. 253 (1963) (vertically imposed restric-

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[5] *White Motor Co.* v. *United States,* 372 U.S. 253, 263 (1963).

tions on territory and customers held subject to rule of reason); *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) (vertically imposed restrictions on territory and customers where manufacturer retained title to product held subject to rule of reason test). The lower court's decision that the trier of fact here undertake a similar analysis entails no more of a burden than that directed in *White Motor* and *Schwinn* and therefore is no less proper.[6]

In any event, the reasons advanced for a *per se* rule —predictability of outcome, ease of application and judicial economy—are insufficient to override a meaningful examination of the effects on competition generated by the challenged practices. The Sherman Act is designed to promote competition by restricting unreasonable restraints of trade. It would be both shortsighted and an affront to the Act's design to foreclose an analysis of the reasonableness and economic effect —both interbrand and intrabrand—in exchange for perceived judicial economies. Indeed, in other fields of law the Court has adamantly resisted suggestions that it avoid making a required analysis because it was difficult, time consuming or not especially amenable to the judicial process. See *Local 761, I.U.E.* v. *NLRB*, 366 U.S. 667, 674 (1961). ("However difficult the drawing of lines more nice than obvious, the statute compels the task") *Franks* v. *Bowman Transportation Company, Inc.*, 424 U.S. 747 (1976) (award of seniority to rem-

[6] *United States* v. *Topco Associates, Inc.*, 405 U.S. 596 (1972) does not require a contrary conclusion. *Topco* involved horizontal territorial restrictions, a classic *per se* violation of the Sherman Act. Since the trade practices in *Topco* were historic "naked restraints of trade with no purpose except stifling of competition" the Court properly rejected an inquiry into associated pro-competitive effects. Equivalent considerations are lacking here.

edy employment discrimination in violation of Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e *et. seq.*). Fulfillment of the antitrust laws requires no less here.

CONCLUSION

For the reasons stated above, as well as those presented by Respondent, the Associated Equipment Distributors urges the Court to affirm the decision of the Court below.

Respectfully submitted,

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